

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Corbett Analyst: Jane Tolman Bill Number: AB 234
Related Bills: See Legislative History Telephone: 845-6111 Introduced Date: January 30, 2003
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: NOL Deduction/100% Deduction For Biopharmaceutical & Biotechnology Business Activities

SUMMARY

This bill would allow special net operating loss (NOL) treatment for biopharmaceutical and other biotechnology business activities.

PURPOSE OF THE BILL

The author's staff has indicated that the purpose of the bill is to provide tax relief for taxpayers engaged in biopharmaceutical and other biotechnology businesses.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable years beginning on or after January 1, 2003.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

An NOL is defined as the excess of allowable deductions (as specifically modified) over gross income. Federal law provides, in general, that an NOL can be carried back two years and forward 20 years. Special rules are provided for the carryback of NOLs arising from specified liability losses, excess interest losses, casualty or theft losses, disaster losses or a small business, and farming losses.

Existing state law conforms to the federal computation of an NOL. However, California does not allow NOL carrybacks. Depending on the type of taxpayer or amount of taxpayer's income, the amount of the NOL that is eligible to be carried forward and the numbers of years it can be carried forward will vary.

The taxpayer must make an election from the following list as to the type of NOL that will cover the NOL the taxpayer has incurred.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director
Gerald H. Goldberg

Date
03/14/03

Existing state law provides for seven different types of NOLs:

Type of NOL	NOL % Allowed to be Carried Over	Carryover Period
General NOL	55% (2000 - 2001) 60% (2002 - 2003) 100% (2004 - on)	10 Years
New Business Year 1 Year 2 Year 3	100% 100% 100%	10 Years
Eligible Small Business	100%	10 Years
Specified Disaster Loss	100% 50%	5 Years 10 Years
Economic Development Areas	100%	15 Years

For most taxpayers, the computed NOL may be carried forward for 10 years as follows:

- For taxable years beginning on or after January 1, 2000, and before January 1, 2002, 55% of the NOL may be carried forward.
- For taxable years beginning on or after January 1, 2002, and before January 1, 2004, 60% of the NOL may be carried forward.
- For taxable years beginning on or after January 1, 2004, 100% of the NOL may be carried forward.
- The election to compute the NOL must be made in a statement attached to original return and is irrevocable this applies to both federal and state elections.

The general NOL rules define “new business” as biopharmaceutical or other biotechnology activities as described in the Standard Industrial Classification (SIC) Manual. As described in the table above, the “new business” is entitled to 100% of the loss for its first three taxable years and the carryover period is 10 years.

All deductions for NOLs for the 2002 and 2003 taxable years have been suspended. However, taxpayers may generate an NOL during the suspension that may be applied when the suspension is removed. When the suspension is lifted the taxpayer may then apply the new NOL loss at 100%.

THIS BILL

For losses incurred during the taxable year beginning on or after January 1, 2003, this bill would allow a special NOL for a taxpayer engaged in biopharmaceutical or other biotechnology business activities. This special NOL would allow a 20-year carryover and would continue to be equal to the federal NOL, thus allowing a 100% deduction for the NOL, (although loss carrybacks would be specifically disallowed, as they are for other taxpayers). The calendar year taxpayer would first be eligible to apply the 2003 NOL in 2004.

For purposes of the general NOL rules, which include the "new business" NOL rules, the definitions of biopharmaceutical and biotechnology business activities would be revised from the SIC to the North American Industry Classification System (NAICS). (The SIC and NAICS contain listings and definitions of industries and business activities.) These definitions would also apply to the special NOL to be added by this bill. It would include medicinal and botanical manufacturing, pharmaceutical preparation manufacturing, in-vitro diagnostic substance manufacturing, and biological product (except diagnostic) manufacturing.

When the original return is filed the taxpayer must elect the type of NOL that will be used for the loss. A statement of this intent must be attached to the return.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department.

LEGISLATIVE HISTORY

AB 2065 (Oropeza, Stats. 2002, Ch. 488) suspended all NOL deductions for the 2002 and 2003 taxable years, extended the carryover period for the suspended years, and provided that for tax years beginning on or after January 1, 2004, the NOL carryover percentage would be 100% of the loss.

SB 38 (Lockyer, Stats. 1996, Ch. 954) under the general NOL statute, included in the definition of new businesses, "taxpayers engaged in certain biopharmaceutical and other biotechnology business activities. ".

OTHER STATES' INFORMATION

The laws of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* were reviewed because their tax laws are similar to California's income tax laws. These states all follow the IRS regulations regarding NOL's and do not provide special treatment for NOL's.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Under the current law, biopharmaceutical and biotechnology firms are treated as new businesses and are allowed to carry forward 100% of their net operating losses for 10 years following the years of losses. For the taxable years beginning on or after January 1, 2003 and before January 1, 2004 this bill would retain the 100% carry-forward provision, but increase the number of years from 10 to 20 years. Therefore, the first revenue impact year for the proposal would be 2014. Since the proposal is prospective and since a large portion of NOLs could be deducted within the first 10 years after the loss occurs, the revenue impact of this bill, while unknown, would not be significant.

The portion of the bill dealing with industrial classification would not have any revenue impact.

Policy Consideration

Current law states that taxpayers that elect to take any NOL other than a general NOL are required to make an irrevocable election. This bill would require taxpayers to elect the special NOL, however, the bill does not specify that the election must be irrevocable. The author may wish to amend the bill to require the election to be irrevocable. Department staff is available to help with this suggested amendment.

LEGISLATIVE STAFF CONTACT

Jane Tolman
Franchise Tax Board
845-6111
Jane.Tolman@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
Brian.Putler@ftb.ca.gov